DEPARTMENT OF STATE REVENUE

02-20130155.LOF

Letter of Findings: 02-20130155
Corporate Income Tax
For the Years Ending June 28, 2008, through July 3, 2010

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ISSUES

I. Combined Reporting – Corporate Income Tax.

Authority: IC § 6-3-2-2(l); IC § 6-3-2-2(m); IC § 6-3-2-2(p); IC § 6-8.1-5-1(c); Indiana Dept. of State Revenue, v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Wabash, Inc. v. Indiana Dept. of Revenue, 729 N.E.2d 620 (Ind. Tax Ct. 2000); Treas. Reg. 1.482-5(a).

Taxpayer argues that the Department erred when it required Taxpayer to file a combined income tax return along with Taxpayer's related "Services Subsidiary."

II. Underpayment Penalty – Corporate Income Tax.

Authority: IC § 6-3-4-4.1(e); IC § 6-8.1-10-2.1(b); IC § 6-8.1-10-2.1(d); 45 IAC 15-11-2(c).

Taxpayer asks the Department to abate a ten-percent penalty on the ground that the penalty was unwarranted.

STATEMENT OF FACTS

Taxpayer is the parent of a multi-state, multinational business which sells premium-priced clothing and fashion accessories. The Department of Revenue conducted an audit review of Taxpayer's business records and tax returns for the tax years ending June 28, 2008, June 27, 2009, and July 3, 2010 ("Tax Years"). The audit resulted in the assessment of additional corporate income tax. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Combined Reporting – Corporate Income Tax.

DISCUSSION

Taxpayer disagrees with the audit's decision requiring that it – and what is here designated as Taxpayer's related "Services Subsidiary" – file combined Indiana income tax returns. Taxpayer argues that the original income tax returns accurately and fairly reflected Taxpayer's Indiana source income and that the Department's audit acted outside its statutory authority when the audit found to the contrary.

A. Background Information.

Taxpayer sells its clothing products and fashion accessories in its own, branded stores. Taxpayer operates some of these branded stores within Indiana. In addition, Taxpayer has a licensing agreement with other retailers authorizing those retailers to sell Taxpayer's branded products domestically. These licensees have the right to distribute Taxpayer branded products domestically by various ancillary channels such as opticians and factory outlet stores.

These licensees pay Taxpayer royalties based on the net sale of the branded products.

A related entity, here called "Services Subsidiary," was established in 2001. "Services Subsidiary" operates a distribution and consumer service facility outside Indiana. "Services Subsidiary" also ships Taxpayer's products to Taxpayer's own branded stores, other department stores, and directly to consumers. According to the audit report:

> [Services Subsidiary's] products are primarily shipped to [Taxpayer's] retail stores and wholesale customers via express delivery providers and common carriers, and direct to consumers via express delivery providers. [Taxpayer's] stores handle returns of [Service Divisions'] products and [Services Subsidiary] handles returns for [Taxpayer's] products. [Taxpayer] negotiates the manufacturing and procurement of [Taxpayer's] products which include eyewear, watches and fragrances.

Taxpayer objects to the above cited description stating that, "[T]he stores accept returns of branded product wherever it was purchased. There is no practical way to distinguish products brought from the stores or from third parties."

Taxpayer and Services Subsidiary share ownership rights to certain intellectual property. The audit report explained the purported relationship between Services Subsidiary, Taxpayer, and the intellectual property generated and exploited by both Taxpayer and Services Subsidiary.

> [Taxpayer] and [Services Subsidiary] together own all of the material trademark rights used in connection with the production, marketing and distribution of all their respective products, both in the U.S. and in other countries in which the products are principally sold. [Taxpayer] and [Services Subsidiary] also own and maintain worldwide registrations and trademarks in all relevant classes of products in each of the countries in which [Taxpayer's] products are sold. [Services Subsidiary] owns all of the trademarks for North America and

Canada. [Taxpayer] owns the trademarks used internationally. There is no separate royalty company . . . holding the patent and trademarks.

While Services Subsidiary reports the income from third-party licensing agreements for which it holds the intellectual property, the documentation presented by Taxpayer provides that Taxpayer employs the "licensing group professionals" that determine the strategy, logistic, and terms of the licensing policy for third-party licensing arrangements. Additionally, it is Taxpayer's vice-president of licensing that has final decision making responsibility for establishing rates paid by third-party licensees.

B. Audit Conclusion.

The Department's audit made an "adjustment" for the audited years to combine Taxpayer with Services Subsidiary to "fairly reflect income from Indiana sources" pursuant to IC § 6-3-2-2(l). In other words, the audit included Services Subsidiary in Taxpayer's Indiana income tax return on a combined basis.

1. Relevant Law.

As authority for requiring that Services Subsidiary and Taxpayer file a combined return, the audit report cited to IC § 6-3-2-2(l).

If the allocation and apportionment provisions of this article do not fairly represent the taxpayer's income derived from sources within the state of Indiana, the taxpayer may petition for or the department may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(1) separate accounting;

(2) for a taxable year beginning before January 1, 2011, the exclusion of any one (1) or more of the factors, except the sales factor;

(3) the inclusion of one (1) or more additional factors which will fairly represent the taxpayer's income derived from sources within the state of Indiana; or

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

As additional authority for requiring that Services Subsidiary file a combined return with Taxpayer, the audit report cited to IC § 6-3-2-2(m) which provides:

In the case of two (2) or more organizations, trades, or businesses owned or controlled directly or indirectly by the same interests, the department shall distribute, apportion, or allocate the income derived from sources within the state of Indiana between and among those organizations, trades, or businesses in order to fairly reflect and report the income derived from sources within the state of Indiana by various taxpayers.

2. Unitary Relationship.

The audit report notes that the Taxpayer and Services Subsidiary have a "unitary relationship," that Taxpayer is involved in all transactions both before and after goods are sold to Services Subsidiary, and that Taxpayer is involved in the design of all products sold by both Taxpayer and Services Subsidiary. The report points out that while Services Subsidiary is responsible for making its own day-to-day decisions, all corporate-wide decisions are made solely by the Taxpayer's corporate officers because Services Subsidiary has no corporate officers of its own. The report also stated that all corporate marketing, payroll, tax, and technology related decisions are made by Taxpayer.

3. Intellectual Property.

As to the parties' intellectual property, the audit report states:

[Services Subsidiary] licenses the use of the trademark names to [Taxpayer] to be used in the stores as [Services Subsidiary] owns all North American Trademarks. [Taxpayer] originally owned all the trademarks but in 2001 it was decided to transfer the North American trademarks to [Services Subsidiary]. [Taxpayer] is paying for marks it already owned and still controls by virtue of its ownership of [Services Subsidiary].

The audit report also points out that:

An examination of [Taxpayer's] federal income shows that about 60[percent] of the income is earned by [Services Subsidiary]. This is in spite of the fact that [Taxpayer] is involved in most of the activity surrounding the manufacture and sale of the product[s].

The audit report concluded that "[t]axable income as reported is therefore distorted because it is not based on economic reality."

4. Transfer Pricing Study.

The audit report did not agree that Taxpayer's 2001 Transfer Pricing Study justified the treatment of intercompany transactions between Taxpayer and Services Subsidiary. The audit report stated:

There are many expenses . . . that are shared between both companies without compensation. Instead what [T]axpayer did was engage an accounting firm to do a transfer pricing study. Instead of computing an arm's length price for intercompany sales, the [T]axpayer broke down the functions of procurement and manufacture of raw materials, distribution and retail sales. Based on extensive analysis, it was decided that [Taxpayer] would earn about 4[percent] of its sales and [Services Subsidiary] would earn about 3[percent] on its sales. Whatever each corporation earns at the end of the year, the [T]axpayer makes an adjustment to adjust income to reflect the 3[percent] and 4[percent] on sales. This means that taxable income for each corporation is based on a pre-conceived estimate of what they should make rather than what they actually make. (Emphasis added).

5. Alternatives.

However, before concluding that Services Subsidiary should be included ("combined") in Taxpayer's Indiana income tax return, the Department's audit representative discussed with Taxpayer's on-site representatives various alternatives. Those alternatives included: (1) "separate accounting;" (2) "[i]nclusion of one or more [additional] factors;" (3) "[d]isallowance of intercompany expenses;" or (4) "[t]he employment of any other method to effectual allocation and apportionment of the [T]axpayer's income."

The three alternatives were rejected for various reasons; the audit rejected "separate accounting" on the ground that the alternative "would not apply as [separate reporting] is usually applied in situations where there are different revenue streams." The audit rejected including one or more additional factors because "an additional factor would not resolve the situation [because] there is no additional property or product sale that is distorting the factors" and because "an exclusion of a factor would not change the situation." Both Taxpayer and the audit rejected the "disallowance of intercompany expenses" because Taxpayer argued that disallowing intercompany expenses "would involve extensive time in analyzing intercompany transactions and would not involve factor relief."

The audit report indicates that "combination was discussed with the [T]axpayer and it was agreed that it was the best choice." Taxpayer nonetheless now objects stating that it never "agreed" that combination was the "best choice." The audit report noted that the Department "sent numerous e-mails to the tax manager and his staff person and left voicemails asking for their input to [the Department's] proposal. They failed to respond with any suggestions or alternatives." Again, Taxpayer objects to the audit report's characterization explaining that "[t]he narrative of what transpired is more complicated . . . ."

C. Taxpayer's Argument.

Taxpayer disagrees with the audit's conclusion and argues that the Department acted prematurely in resorting to the combined reporting methodology because the Department failed to demonstrate that there was any degree of distortion in the manner in which Taxpayer originally reported its Indiana source income. Taxpayer correctly cites to IC § 6-3-2-2(p) as limiting the Department's authority to require a combined return.

> Notwithstanding subsections (l) and (m), the department may not require that income, deductions, and credits attributable to a taxpayer and another entity not described in subsection (o)(1) or (o)(2) be reported in a combined income tax return for any taxable year, unless the department is unable to fairly reflect the taxpayer's adjusted gross income for the taxable year through use of other powers granted to the department by subsections (l) and (m). (Emphasis added).

Taxpayer summarizes what it regards as the pre-requisites to mandating a combined return.

> First, the Department must show that the standard apportionment and allocations provisions do not fairly reflect the taxpayers' Indiana source income. This requirement appears in both [IC § 6-3-2-2(l) and IC § 6-3-2-2(o)]. Second, the Department must show that the taxpayer is unitary with the corporation or corporations that the Department is seeking to include in a combined return with the corporation or corporations that the Department is seeking to include in a combined return with the taxpayer. Finally, pursuant to [IC § 6-3-2-2(p)], the Department must show that it is unable to fairly reflect the taxpayer's Indiana source income using any other method allowable under subsections (l) and (m).

As further authority for its argument that the Department was unjustified in requiring that Taxpayer and Services Subsidiary file a combined return, Taxpayer cites to the Indiana Tax Court's decision in Wabash, Inc. v. Indiana Dept. of Revenue, 729 N.E.2d 620 (Ind. Tax Ct. 2000). That decision states that "the standard [apportionment] formula may be used unless the Department proves that the income attributed to Indiana from using that formula is out of proportion to the business transacted in Indiana."

Taxpayer disagrees with the audit's conclusion challenging the relevance of the Transfer Pricing Study stating that "[t]here is consideration paid for all services performed by either entity on behalf of the other." Taxpayer states that there were "intercompany agreements" in effect between Taxpayer and Services Subsidiary during the audit period which required that both parties received "arm's-length" compensation "for the services provided and value imparted" and that the "arm's-length" compensation was established by the 2001 Transfer Pricing Study as "required by the intercompany agreements."

In the face of the audit's conclusion that the intercompany transactions did not reflect "economic reality," Taxpayer maintains that its 2001 Transfer Pricing Study "supports the intercompany pricing and [Taxpayer's] originally filed separate company return." Taxpayer states that the Transfer Pricing Study established that the Services Subsidiary "provides valuable distribution services for [Taxpayer] including receiving, processing, and shipping products manufactured by independent foreign manufacturers." In addition, Services Subsidiary "inspects the products upon arrival to ensure that they adhere to [Taxpayer's] quality standards" and the Services Subsidiary "processes returns . . . handles repairs and customer services responsibilities as well as the licensing arrangements." Taxpayer concludes that Services Subsidiary "bears the risk of inventory, the risk of shrinkage, product liability/defect risk and margin risk on defective/lower quality products."

Taxpayer explains that the 2001 Transfer Pricing Study concluded that Services Subsidiary "most closely resembles a retail distributor in the direct distribution channel," and that in the indirect distribution channel that

Services Subsidiary "most closely resembles that of a wholesale distributor." Therefore, the Transfer Pricing Study "performed extensive searches in order to identify comparable independent retail and wholesale distributors operating in the United States."

Taxpayer states that after having "identified comparable retail and wholesale distributors, the Transfer Pricing Study applied the CPM [comparable profits method] to establish an arm's length rate of return." According to Taxpayer:

> The transfer pricing study concluded that the direct distribution channel should result in an interquartile range of 2.0 percent to 4.4 percent and recommend that [Taxpayer] earn a 4 percent operating margin, while the indirect channel should result in an interquartile range of 2.3 percent to 5.3 percent and recommend that [Services Subsidiary] earn a 3 percent operating margin.

The "comparable profits method" is explained at Treas. Reg. § 1.482-5(a) which provides:

> The comparable profits method evaluates whether the amount charged in a controlled transaction is arm's length based on objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances.

Taxpayer's Transfer Pricing Study ("Study") explains its analysis of comparable retail and wholesale distributors. According to the Study, the preparer reviewed "a sample of unrelated companies whose functions and risks are similar to those of the retail sales channels in the transaction under review . . . ." The Study's preparers initially reviewed 146 companies but reduced that number to "two companies after the application of the . . . criteria." After further review which allowed the preparer "to more thoroughly apply the . . . criteria," the preparer selected one company but then relaxed its comparability criteria to include some companies which "perform some distribution, as long as their primary function was retailing." In the end, the preparer evaluated ten companies.

In its search for comparable wholesalers, the Study's preparer "identified 197 potentially comparable companies . . . " which was then "reduced to 18 companies after the application of the . . . criteria." In the end, the Study's preparer selected one company as a comparable wholesaler but, "because the number of comparable firms was so small, we relaxed our product comparability criteria to include all products." This resulted in a review of "five selected comparable wholesalers."

Taxpayer states that Indiana law requires that the Department defer to the conclusions contained within the Transfer Pricing Study. Taxpayer explains:

> It is worth noting that the definition of "adjusted gross income" for a corporation pursuant to IC 6-3-1-3.5(b) incorporates IRC § 482 due to its adoption of federal taxable income pursuant to IRC § 63 as a starting point. Thus a transfer pricing study that is performed in compliance with IRC § 482, is also by definition consistent with IC 6-3-2-2(l) and (m).

Taxpayer asserts that the audit report "does not present any evidence that the Transfer Pricing report does not properly calculate arm's length pricing between [Taxpayer] and [Services Subsidiary] or that the report is in any way defective."

In addition, while admitting that the Transfer Pricing Study was completed during 2001, Taxpayer argues that its "business model has not experienced significant change since [2001]" and that the "economics associated with the various operations remain unchanged."

Taxpayer also disagrees with the audit's suggestion that Taxpayer transferred its intellectual property to Services Subsidiary without consideration and that "[Taxpayer] is paying for [trade]marks it already owned and still controls by virtue of its ownership of [Services Subsidiary]."

Taxpayer explains that it transferred its intellectual property to Services Subsidiary by means of a 2001 "Assignment agreement" in which it transferred to Services Subsidiary "all domestic patents, patent applications, trademarks, trademark applications, trademark registrations, trade names and knowledge . . . to [Services Subsidiary] for valuable consideration." Insofar as the issue of "consideration," Taxpayer explains that it "would no longer be responsible for maintaining the Intellectual Property and defending against infringements" and that Services Subsidiary "would now bear the burden of defending against infringements as well as maintaining and strengthening the [Taxpayer's] brand." Taxpayer summarizes:

> [T]he assignment of the Intellectual Property by [Taxpayer] to [Services Subsidiary] and the subsequent sales agreement between [Services Subsidiary] and [Taxpayer] relieved [Taxpayer] from the obligation of maintaining the Intellectual Property and defending against infringements, while enabling both parties to utilize the Intellectual property, within the confines of their particular distribution channel, royalty free.

D. Issue.

The issue is whether the Department's audit was justified in requiring that Taxpayer and Services Subsidiary file a combined income tax return on the ground that Taxpayer's separate company return failed to fairly reflect Taxpayer's Indiana source income because of the intercompany transactions between Taxpayer and Services Subsidiary. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made. See Indiana Dept. of State Revenue, v. Rent-A-Center East, Inc., 963 N.E.2d 463, 466 (Ind. 2012) (citing IC § 6-8.1-5-1(c)).

In order to prevail in its protest, Taxpayer is required to establish that the audit's determination – that

Taxpayer and Services should file a combined return – was "wrong."

1. Transfer Pricing Study / Scope and Relevance.

Taxpayer's own reporting methodology reduces its Indiana income tax liability by approximately 50 percent. Taxpayer relies on a Transfer Pricing Study issued in 2001 to justify a 50 percent reduction in state tax liability. The Department raises legitimate concerns whether a twelve-year old study is sufficiently relevant or reliable to justify the claimed tax effect. Taxpayer itself recognizes this obvious discrepancy and states that its "business model has not experienced significant change since this time [and that] the economics associated with the various operations remain unchanged." Other than Taxpayer's bare assertion to that effect, Taxpayer has provided no specific information sufficient to establish that Taxpayer's retail, Internet, and wholesale business remains unaffected by the passage of twelve years or that the state of the national economy has left Taxpayer's business model and its economic relationship with Services Subsidiary unaffected.

However, even assuming that the Transfer Pricing Study was entirely relevant to an analysis of transactions which occurred during the audit period, the Transfer Pricing Study exhibits certain inconsistencies and deficiencies which are not adequately explained in or justified within the Transfer Pricing Study.

The Transfer Pricing Study was limited in scope from the Study's inception. The Study reviewed only "the distribution of finished goods by [Services Subsidiary]." The Study cautioned that "any other intercompany transactions are outside the scope of this analysis and, for purposes of this study are assumed to take place at arm's length." (Emphasis added). However, Taxpayer presents the study as sufficient to account for and reconcile Taxpayer and Service Division's numerous intercompany transactions. During the audit, Taxpayer rejected a suggested alternative method disallowing intercompany expenses "because it would involve extensive time in analyzing intercompany transactions." Given the limited scope of the Study's analysis, the Department is not satisfied that the Study thoroughly considered the parties' extensive intercompany transactions.

2. Brand Recognition / Administrative Functions.

The Department must also question whether the Transfer Pricing Study adequately considered the value of the brand recognition or the value of the front and back office functions that Taxpayer brings to its relationship with Services Subsidiary. As Taxpayer notes, "[Taxpayer] is one of the best-recognized brands in the United States . . . ." In addition to brand name recognition, Taxpayer brings its experience in design and product development, procurement, oversight of all product manufacturing, head office management, along with all "back-office" functions such as accounting and payroll. There is insufficient evidence that the Transfer Pricing Study recognizes the substantial contribution Taxpayer brings to its relationship with its distribution arm, the value of its strategic decision-making, or the inherent value Taxpayer adds to its premium-priced retail products. As noted in the audit report:

> [Taxpayer] is involved in the transaction both before and after it is sold to [Services Subsidiary]. [Taxpayer] is involved in the design and materials to be incorporated into a product. It has complete control over how it is manufactured. [Taxpayer's] corporate officers have complete control over decision making at [Services Subsidiary]. Although [Services Subsidiary] handles daily decisions at its distribution center . . . . corporate decisions as to direction of the company are made by officers at [Taxpayer]. [Services Subsidiary] has no corporate officer salaries on its return. The only salaries they show are for the distribution center employees . . . .

Further, the Department also questions whether the Study recognizes the value Taxpayer contributed to its distribution arm when Taxpayer funded the third-party development of the "highly advanced and automated technology" central to Service Division's distribution facilities.

Whatever may be the actual value of Taxpayer's fashion accessories, both Taxpayer and the Department acknowledge that the brand name recognition and trademarks substantially enhance the actual retail value of those goods. However the Department must question whether the Transfer Pricing Study adequately considers the value of the intellectual property developed by Taxpayer and thereafter transferred to and shared by Services Subsidiary. As noted in the audit report:

> [Taxpayer] is paying for marks it already owned and still controls by virtue of its ownership of [Services Subsidiary].

Taxpayer acknowledges these issues but states that Taxpayer received adequate compensation for the value of the intellectual property because Services Subsidiary took upon itself the burden of protecting and managing the intellectual property. Whatever credence may be given to Taxpayer's assertion, there is nothing which substantiates the value of the compensation Taxpayer received as compared to the value of the intellectual property transferred to Services Subsidiary.

3. Transfer Pricing Study's "Comparables."

Taxpayer points out that Services Subsidiary "most closely resembles a retail distributor" when it functions as a "direct distribution channel" and that when it functions as an "indirect distribution channel," it "most closely resembles that of a wholesale distributor." However, the Department questions whether the Transfer Pricing Study's review of "comparable retail distributor[s]" and "comparable wholesalers," was entirely sufficient. In each case, the Study's search for "comparables" yielded exactly one "comparable" which the Study itself concluded "was so small." In recognition of that obvious shortcoming, the Study resorted to adding four "comparable" wholesalers and nine "comparable retailers." However, there is little to substantiate that these thirteen various "add-ons" are analogous to Taxpayer's own business model especially when – as here – Taxpayer's business is so closely related to the brand name value inherent in the products Taxpayer creates and Services Subsidiary distributes.

Moreover, Taxpayer's Transfer Pricing Study, after determining the relevant "comparables," performed its analysis on a prospective basis. "For [Services Subsidiary] to earn this return, it must bear risks similar to those of comparable wholesale firms." The Study discusses the three types of risks that Services Subsidiary must bear in order to be comparable to wholesale firms which – at the time the study was performed – were borne by Taxpayer. The Study appears to arrive at it conclusion based on an examination of what should be and instead of what then presently existed. Taxpayer has not provided information that establishes whether these risks were subsequently shifted to Services Subsidiary.

4. Conclusion.

Although the Transfer Pricing Study may have had a certain, limited value at the time it was first issued and which may have assisted the parties in better understanding the financial and organizational relationship between the affected parties, the Department concludes that the Transfer Pricing Study is insufficient to establish the audit acted outside its statutory authority in requiring Taxpayer and Services Subsidiary file combined income tax returns in order to "fairly reflect and report the income derived from sources within the state of Indiana . . . ."

Taxpayer and the Department may disagree as to what does and does not reflect "economic reality," but the Department is unconvinced that the Transfer Pricing Study authoritatively reflects that reality. The annualized "adjustments" – allocating four percent of its earnings to Taxpayer and three percent of its earnings to Services Subsidiary based upon the limited scope of the Transfer Pricing Study – appear arbitrary and not fully warranted by the value and services each party brings to their relationship.

FINDING

Taxpayer's protest is respectfully denied.

II. Underpayment Penalty – Corporate Income Tax.

DISCUSSION

Taxpayer asks that the Department abate a ten-percent penalty which was assessed because taxpayer purportedly underpaid estimated taxes. Taxpayer challenges the penalty "regardless as to whether they represent negligence penalties or underestimated penalties." Taxpayer further explains that it "filed its returns following the prescribed statutory requirements . . . ."

Insofar as the "underpayment penalty," IC § 6-3-4-4.1(e) states as follows:

> The penalty prescribed by IC 6-8.1-10-2.1(b) shall be assessed by the department on corporations failing to make payments as required in subsection (d) or (g). However, no penalty shall be assessed as to any estimated payments of adjusted gross tax plus supplemental net income tax plus gross income tax which equal or exceed:
>
> (1) twenty percent (20[percent]) of the final tax liability for such taxable year; or
>
> (2) twenty-five percent (25[percent]) of the final tax liability for the taxpayer's previous taxable year.
>
> In addition, the penalty as to any underpayment of tax on an estimated return shall only be assessed on the difference between the actual amount paid by the corporation on such estimated return and twenty-five percent (25[percent]) of the sum of the corporation's final adjusted gross income tax plus supplemental tax income tax liability for such taxable year.

IC § 6-8.1-10-2.1(b) sets the amount of penalty as ten percent. However, IC § 6-8.1-10-2.1(d) provides:

> If a person subject to the penalty imposed under this section show that the failure to file a return, pay the full amount of tax shown on the person's return, timely remit tax held in trust, or pay the deficiency determined by the department was due to reasonable cause and not due to willful neglect, the department shall waive the penalty.

Departmental regulation 45 IAC 15-11-2(c) requires that in order to establish "reasonable cause," the taxpayer must demonstrate that it "exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed . . . ."

Based upon the particular facts and circumstances attendant upon this Taxpayer, the Department is agrees that Taxpayer has established reasonable cause sufficient to warrant abating the penalty.

FINDING

Taxpayer's protest is sustained.

SUMMARY

Taxpayer's challenge to the ten-percent penalty is sustained; in all other respects, Taxpayer's protest is denied.

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